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IN THE

Supreme Court of the United States

October Term, 1982

MARTIN E. HECHT and INVENTEL CORPORATION,

Petitioners,

against

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR CERTIORARI

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Questions Presented

1. When the purchaser of a territorial license to distribute a product simultaneously retains a sales agent to assist in the distribution of the product, is the transaction an "investment contract" within the meaning of the federal securities laws if:

> (A) the licensee has warranted that he possesses both the knowledge and the financial requirements to market the product himself without the assistance of the sales agent; and
>
> (B) the licensee has the unqualified right to control all aspects of the venture himself and, if he chooses to retain a sales agent, possesses the absolute right to terminate the sales agent on short notice; and
>
> (C) as found by the courts below, the efforts of the sales agent in marketing the product require no special expertise, and each licensee possesses sufficient business experience and background to exploit his license himself?

The Courts below held in the affirmative, rejecting clear precedent to the contrary in the Courts of Appeals for the Fifth Circuit (*Williamson* v. *Tucker*, 645 F.2d 404 [5th Cir.], *cert. denied*, 102 S.Ct. 396 [1981]); the Tenth Circuit (*Mr. Steak* v. *River City Steak, Inc.*, 460 F.2d 666 [10th Cir. 1970]); and the Eighth Circuit (*Fargo Partners* v. *Dain Corp.*, 540 F.2d 912 [8th Cir. 1976]), all of which have held that an offering is not an "investment contract" where, although it is contemplated that most or all of the operations of the enterprise will be performed by the promoter or third parties, the purchaser has retained the legal right and the practical ability to exercise control of the business.

2. Is this Court's decision in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946), setting forth the three-pronged test for an "investment contract"—(1) an investment of money, (2) in a common enterprise, (3) in an expectation of profits to be derived solely from the efforts of individuals other than the purchaser—no longer the law?

The courts below answered this question in the affirmative.

Parties

In the United States Court of Appeals for the Second Circuit, the parties were: Martin E. Hecht and Inventel Corp., appellants, and The Securities and Exchange Commission, appellee.

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PETITION FOR CERTIORARI

The petitioners, Martin E. Hecht and Inventel Corporation, pray that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

Opinions Below

The opinion of the Court of Appeals (Friendly, Kaufman, and Pierce, C.JJ.) is not yet reported. It is reproduced at 1a.*

* All page references are to the pages of the Appendix.

The opinion of the United States District Court for the Southern District of New York is reported at 524 F.Supp. 66 (S.D.N.Y. 1981). The opinion is reproduced at 20a.

Jurisdiction

The judgment of the Court of Appeals was entered June 10, 1982. See 55a.

The *certiorari* jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

Statutes and Rules Involved

Securities Act of 1933, 15 U.S.C. §§77e(a), 77e(c) and 77q(a).

Securities Exchange Act of 1934, 15 U.S.C. §78j(b).

Securities Exchange Act of 1934, Rule 10b-5.

Statement of the Case

This case concerns a plan to market a new dental product created by the inventor of Cavitron, a highly successful ultrasonic device in use in approximately half of the dental operations in the United States. The promoters of the product sold throughout the United States licenses to sell the product in certain geographic locations. Respondent sought to enjoin the offering on the ground that it was in violation of the federal securities laws. The only issue

raised in the courts below was whether there was federal jurisdiction, that is, whether the offering of the licenses fit within the definition of an "investment contract" and was therefore a security. It was conceded that if the offering constituted an "investment contract," the federal securities laws had been violated.

The District Court, after a non-jury trial, made findings of fact and conclusions of law, which led to the issuance of a limited permanent injunction against petitioners Martin E. Hecht and Inventel Corporation.

Petitioners appealed the judgment of the District Court to the Court of Appeals for the Second Circuit, which unanimously affirmed.

This Court should grant *certiorari* to resolve a conflict between the Courts of Appeals for the Fifth, Eighth and Tenth Circuits, on the one hand, and the Second Circuit on the other, concerning the following issue, squarely presented in this case: If a purchaser of a business venture elects to accept management or marketing services to be performed by the promoter or other third parties, yet retains the legal right and practical ability to control the entire operation himself, does the transaction fall within the definition of an "investment contract"—even where the acceptance of such management services might "reasonably have been expected by the promoter"?

The Courts of Appeals for the Fifth, Eighth and Tenth Circuits have all held that under these circumstances an "investment contract" does not exist. The Court of Appeals for the Second Circuit here held to the contrary.

In addition, this Court should grant *certiorari* to resolve an issue specifically reserved by this Court in *United Housing Foundation* v. *Forman*, 421 U.S. 837, 851, fn.16 (1975), *viz.*, does the test under *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946) for determining whether an investment contract exists—whether the purchaser has relied "solely on the efforts of the promoter or a third party"—mean what it says or, should the court adopt a new test?

The Relevant Facts

The facts relevant to this *certiorari* petition, as found by the District Court and not disturbed by the Court of Appeals,* are as follows: an inventor, Arthur Kuris, had developed a dental device called the Cavitron, that employed ultrasonic waves to dislodge plaque during a dental prophylaxis. The new Kuris invention (an advance over the Cavitron) would allow the use of sterile, instead of, tap water, which would thus reduce the risk of infectious disease and contamination to dental patients (22a-23a).

Kuris consulted a friend, an attorney, who thereafter introduced Kuris to his law partners, one of whom happened to be petitioner Hecht. The attorneys discussed with Kuris how to market and distribute the dental improvement, later identified as Steri Products (22a-23).

These discussions led to the formation of a corporation, Aqua-Sonic Products Corp. ("Aqua-Sonic"), which acquired the rights to manufacture and distribute Steri Products. It was proposed that Aqua-Sonic offer territorial licenses to third parties, permitting the sale of Steri Products in certain geographic locations (23a-24a).

* Petitioners are content to rely exclusively upon facts found by the District Court. The issue is solely one of law.

Another corporation, Ultrasonic Dental Products Inc. ("Ultrasonic"), was formed to offer an additional, optional service to the Aqua-Sonic licensees. Ultrasonic offered, for a fee, to make available to the licensees assistance in the marketing of Steri Products. The Aqua-Sonic licensees, under the offering, were not required to purchase the services offered by Ultrasonic (29a-31a).

The Sale of the Licenses

The promotion of the Aqua-Sonic enterprises included the distribution of photographs of certain prototype models of the dental products and various documents, including an Information Memorandum, which summarized the obligations of the licensees in the licensing agreement as follows:

> "The License Agreement delineates the relationship between parties and *imposes specific duties and obligations on the Licensee.* These duties include, but are not limited to: (a) *vigorous promotion* of the distribution and sales of the Products Parts and Supplies; (b) *maintenance and employment of sufficient working capital* and net worth to enable Licensee to fulfill all of his duties, obligations and responsibilities under the License Agreement; (c) employment of such agents, representatives and employees as Licensee in his *sole discretion,* may deem to be necessary to assist him in the performance of some or all of his duties and obligations as Licensee; (d) *use and maintenance of an accounting and reporting system* as may be required by Licensor; . . . and (f) adherence to certain standards for advertising materials used in connection with the business.
>
> • • •
>
> "*Licensee will be an independent contractor and be solely responsible for all expenses and costs* incurred

by him in the conduct and promotion of his business. In addition, Licensee will be required to and be responsible for the vigorous and satisfactory promotion, distribution and sale of the Products, Parts and Supplies for use in his Territory so as to obtain a reasonable share of the market. . . . *In the event that a Licensee does not satisfactorily fulfill his duties and responsibilities as set forth in the License Agreement, Licensor may elect to terminate his license.*" [emphasis supplied] (28a-29a).

The Information Memorandum did not mention the offer by Ultrasonic to act as a sales agent for the licensees. The Information Memorandum simply provided on this point that:

"The choice as to whether to deal with Dental Depots[1] and/or to retain agents, representatives, employees or others is solely that of the Licensees. *The Licensor takes no position on this matter,* for the most effective means of achieving satisfactory market penetration will vary according to the prior experience of the Licensee, the amount of time and effort the Licensee is willing to expend to exploit the License, and the nature of Licensee's territory". [emphasis supplied] (29a)

The Information Memorandum stated further:

"In the event that a Licensee, in his sole discretion, elects to retain and/or employ anyone to assist him in the performance of some or all of his duties, obligations and responsibilities under the License, Licensee

1. The Information Memorandum pointed out that most sales of dental products were accomplished through so-called "Dental Depots," essentially wholesale operators which acted in each territory as sales agent for the manufacturer. Use of Dental Depots would have rendered the sales agent, Ultrasonic, unnecessary.

> *must undertake to actively supervise their activities* on his behalf to ensure that they perform their activities in a manner which will be consistent with Licensee's activities and responsibilities to Licensor". [emphasis supplied] (30a)

The Information Memorandum and the license application also specified that the territorial license offered by Aqua-Sonic was being made available only to a limited to class of persons. Under a separate heading in the Information Memorandum, "Who Should Apply for a License," the Information Memorandum stated:

> "A License will be granted only to a person who has *considerable knowledge and experience in financial and business matters,* appreciates and understands the merits and economic risks of this business. Experience has shown that this type of business is not suitable for and should not be pursued by persons who lack substantial assets. . . .
>
> "A License will be granted only to an Applicant in reliance on *his representations and warranties* that he has himself, or together with any business and financial advisor with whom he may consult, knowledge and experience in financial and business matters, that he is capable of evaluating the merits and risks of this transaction, and that he is able to bear the economic risks of this transaction". [emphasis supplied] (31a)

The License Application specified that each applicant must represent and warrant that:

> "4. Applicant and/or his designated representative has such knowledge and experience in financial and business matters, and investments in particular, that he is capable of evaluating the merits and risks of the Applicant's acquisition of a License and has

obtained, in Applicant's judgment, sufficient information from Licensor relating to the License to evaluate the merits and risks of the contemplated transaction." (31a)

The Sales Agency

The promoters also provided prospective licensees with a copy of the Ultrasonic sales agency agreement. However, neither the District Court nor the Court of Appeals cited any material touting the expertise of Ultrasonic or indicating that Ultrasonic or its principals had any experience with the sale of dental products. Indeed, there was none.

The Ultrasonic sales agency agreement contained three noteworthy provisions pertinent here:

1. The agreement provided that an Aqua-Sonic licensee had the absolute right to cancel the services of the sales agent upon ninety days' written notice;

2. the agreement also stated that any orders of dental products solicited by the sales agent were subject to the complete approval of the licensee; and

3. the agreement provided that price and other terms of all sales were set by licensee. (32a)

The Licensees

The SEC sought to prove at trial (1) that distribution of dental products was a highly specialized activity requiring a centralized sales agency; and (2) that the licensees were, themselves, incapable of exploiting their licenses without the use of a sales agent. The District Court *rejected* both claims, finding:

"No probative evidence was offered [concerning the need for a centralized sales agency] nor could any

findings be made concerning the ability of the licensees to conduct their proposed business. . . ." And further "there was insufficient evidence upon which it would be found, as opposed to surmised, that the licensees were not capable of vigorously promoting the sale of Steri Products as they had warranted to do". (44a-45a)

In short, the District Court found, and the Court of Appeals did not disagree, that the licensees had both the legal right and the practical ability to exploit their licenses on their own without utilizing the services of a sales agent.

In nonetheless sustaining jurisdiction under the federal securities laws, the District Court relied heavily on the fact that while the licensees were able to perform sales functions without Ultrasonic, they were nonetheless dependent on the efforts of others because they could not distribute any products unless those products were first *manufactured* by Aqua-Sonic. The District Court rejected petitioners' argument that all sales dealerships and franchises are clearly not "investment contracts" although similarly dependent upon their manufacturers for products (*cf.* a typical automobile dealership). (45a)

The Court of Appeals, in its opinion affirming the judgment of the District Court, completely ignored the legal reasoning of the District Court, rejected the precedent of this Court and of the Fifth, Eighth and Tenth Circuits, and created its own novel test under which it held that the Aqua-Sonic offering was a security. The Court of Appeals radically shifted the test for gauging an investment contract away from the reasonable expectations of the *investors* and their legal and practical rights to control their investment[2]

2. *Williamson* v. *Tucker*, 645 F.2d 404, 421 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 396 (1981); *Mr. Steak, Inc.* v. *River City Steak, Inc.*, 460 F.2d 666 (10th Cir. 1972); *Fargo Partners* v. *Dain Corporation*, 540 F.2d 912 (8th Cir. 1976); *Schultz* v. *Dain Corporation*, 568 F.2d 612 (8th Cir. 1978).

and focused instead on whether the *promoter* could reasonably have expected the investors to take advantage of their legal rights and practical opportunities. The Second Circuit stated that the test is:

> "whether under all the circumstances, the scheme was being promoted primarily as an investment or as a means whereby participants could pool their own activities, their money and the promoter's contribution in a meaningful way." (13a)

The Second Circuit then held that the transaction was an investment contract because it was not "reasonable to expect investors to exercise their retained rights under the sales agency agreement. . . ." (18a).

The Second Circuit rejected the test set forth in *Williamson* v. *Tucker, supra* (Fifth Circuit), all but ignored *Mr. Steak, supra* (Tenth Circuit) and completely ignored *Fargo* and *Schultz, supra* (Eighth Circuit). In particular, the Second Circuit *expressly rejected* as a sufficient test the following language in *Williamson* (645 F.2d at 421):

> "In each case the actual control exercised by the purchaser is irrelevant. So long as the investor has the right to control the asset he has purchased, he is not dependent on the promoter or on a third party for 'those essential managerial efforts which affect the failure or success of the enterprise'." (17a)

In addition to rejecting the test applied in the Fifth, Eighth and Tenth Circuits, the Second Circuit also rejected a literal reading of this Court's decision in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946) that for an investment contract to exist, the purchaser must rely "solely" on the efforts of others.

Reasons for Granting the Writ

I

This Court should grant certiorari in order to resolve the conflict between the holding by the Court of Appeals for the Fifth Circuit in *Williamson* v. *Tucker* following the Eighth and Tenth Circuits and the decision reached by the Court of Appeals for the Second Circuit in the Court below.

In *Williamson* v. *Tucker*, 645 F.2d 404 (5th Cir. 1981), *cert. denied*, 102 S. Ct. 396 (1981), the Court of Appeals for the Fifth Circuit ruled that the sale of a business together with an offer by the promoter to manage the entire business does not constitute an investment contract if the purchaser has retained a non-illusory power to control his business. There, the promoter had sold several joint venture interests in real estate but, pursuant to the contract of sale, continued to act as the sole manager of the properties. The promoter's management services were not offered as an option to the purchasers, but were part and parcel of the purchase transaction. All the purchasers received was naked title in the form of a joint venture interest. Nonetheless, the management services were terminable by the purchasers and the manager's activities in running the operation were theoretically subject to the approval of the joint venturers, who were thus held to have retained a *latent* power of control.

The Court of Appeals for the Fifth Circuit extensively surveyed the development of the law with respect to investment contracts and, using *SEC* v. *W.J. Howey Co.*, 328 U.S.

293 (1946) as the starting point, concluded that the joint venture interests were not securities, stating:

> "So long as the investor has the *right* to control the assets he has purchased, he is not dependent on the promoter or on a third party for 'those essential managerial efforts which affect the success of the enterprise.'" (645 F.2d at 421) [emphasis supplied]

The Fifth Circuit also wrote:

> "A reliance on others does not exist merely because the partners have chosen to hire another party to manage their investment. The delegation of rights and duties—standing alone—does not give rise to the sort of dependence on others which underlies the third prong of the *Howey* test. An investor who retains control over his investment has not purchased an interest in a common venture 'premised on the reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others,' even if he has contracted with the vendor for the management of the property. [citations omitted]. *So long as the investor retains ultimate control,*[3] *he has the power over the investment and access to information about it which is necessary to protect against any unwilling dependence on the manager. It is not enough, therefore, that partners in fact rely on others for the management of their investment. . . .*" (Id. at 423-24) [emphasis supplied]

3. The Court of Appeals in *Williamson* was careful to point out that a clever promoter could not evade the securities laws by giving purchasers an illusory right to control the purchase. Thus, the Court said that an investment contract might exist where the purchaser does not possess the requisite knowledge and business experience to enable him to exercise intelligently his right to control. The type of expertise discussed in *Williamson* was mere general business experience, not specific expertise in the subject matter of the venture. At bar, the District Court did not find that the licensees lacked the

(footnote continued on next page)

Also pertinent here is *Mr. Steak* v. *River City Steak, Inc.*, 460 F.2d 666 (10th Cir. 1972), which involved the sale of a franchise to operate a restaurant. The franchisee's role in the operation of the franchise was at best nominal. The restaurant was built according to plans and specifications of the franchisor on land leased by franchisor and subleased to franchisee. The agreement provided that the franchisee *could* select a manager for the restaurant, but that if the franchisee failed to do so, the franchisor could choose and train the manager itself. In practice, the franchisor hired the manager without consulting the franchisee. The franchise agreement provided that the *manager* (not the franchisee) was the *only* person permitted to actively manage the restaurant. Moreover, even supervisory powers over the manager were stripped from the franchisee (234 F. Supp. at 643).[4]

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requisite experience to operate the venture. More than that, the licensees, as a condition of purchasing the licenses were required to warrant in writing that they possessed the capacity—knowledge of financial and business matters—to carry on the business.

Williamson also held that the right to control a venture might be illusory if the purchaser were dependent on the unique expertise or managerial talents of the promoter or third party, thus making him indispensable. At bar, the District Court expressly refused to make a finding to that effect proffered by the SEC. (See 44a-45a.)

4. According to the District Court, the agreement provided:

> "'The ASSOCIATE [franchisee] hereby irrevocably grants to MR. STEAK the power to supervise, instruct and direct the activities, duties and functions of the Investor-Manager and in the event the Investor-Manager does not comply with any directive or recommendation by MR. STEAK, then the ASSOCIATE hereby agrees that MR. STEAK can, at its absolute discretion, remove said Investor-Manager from the active operation of the ASSOCIATE'S MR. STEAK restaurant herein and replace him with another individual chosen by MR. STEAK.'"
>
> * * *
>
> "The franchisee has no voice in his replacement." (324 F. Supp. at 643)

Further, the franchisee was also *required* to abdicate to the franchisor total "control over the financial affairs." (*Id.*)

The Court of Appeals, affirming the District Court's determination that the franchise was not an investment contract, held that:

> "[T]he relationship is to be examined on the basis of what the agreements *permitted the defendant to do* and *not what it actually did* in the way of supervision and management." (460 F.2d at 669) [emphasis supplied]

Quoting at length from the District Court's opinion, the Court of Appeals found the following to be significant (460 F.2d at 669-70):

> "*The role of the franchisee was envisioned as a flexible one, depending upon the business expertise and inclination of the franchisee.* Most duties mentioned in the franchise agreement could be performed by the franchisee, or delegated to the manager. *That River City Steak delegated performance of those duties and ignored daily operations does not affect the nature of its powers* nor change the essential fact that River City Steak abandoned what rights of control and participation it did have." [emphasis supplied]

In short, the Court of Appeals held that where the franchisee had the *opportunity* to exercise some managerial control, if only "the power to terminate" the manager, he could not later complain that he failed to avail himself of that opportunity.

Schultz v. *Dain*, 568 F.2d 612 (8th Cir. 1978) and *Fargo* v. *Dain*, 540 F.2d 912 (8th Cir. 1976) are also in point. In

each case, the defendant sold to plaintiff an interest in real property and simultaneously executed a contract with plaintiff giving defendant the exclusive right to manage the property on plaintiff's behalf.

In *Fargo*, the purchaser retained the right to cancel the management contract on 30 days' notice, and the Court of Appeals relied in part on that right in holding that the transaction did not constitute the sale of a security. The Court said, at page 915 of 540 F.2d:

> "It is clear, however, that Fargo's role was a significant one despite the management contract. Fargo retained *ultimate control of the operation of the apartment complex by reserving the right to fire Candletree as its manager on thirty days' notice. Whether it chose to exercise that right or was content to give Candletree a free hand is irrelevant; the power to control the business was in Fargo's hands.*
>
> . . . There is no showing that Fargo was *required* to accept a package deal in which the management services went with the apartment complex; certainly under the terms of the agreement it was free to dispense with those services. Under these circumstances an essential pre-requisite for the existence of an investment contract—substantial reliance on the efforts of the seller or third parties for a return on the investment—is lacking." [emphasis supplied]

In *Schultz*, unlike *Fargo* and unlike Aqua-Sonic, the plaintiff did *not* even have the right to cancel the management agreement on short notice. Nonetheless the Court of Appeals found that a security was not present because the operation of the property was "subject to . . . [purchaser's] inspection and approval" (568 F.2d at 615) and because

"[a]s owner of the complex, Schultz was free to enter into the management contract and to negotiate its terms." (*Id.*)

As in *Mr. Steak*, the Court of Appeals in *Fargo* and in *Schultz* thus found that the determinative factors were the *potential* or *latent power* of the purchaser to manage the property himself (*i.e.* not hire a manager) and the *potential or latent control* of the owner over the manager, either by right to terminate or by right of inspection. Whether this power or control was *actually* invoked was irrelevant.

A fortiori, the arrangements here did not constitute investment contracts.

At bar, the District Court recognized that the licensees possessed the right to control the venture, and possessed sufficient business and financial background to make the business work and, also that the promoter was not rendering indispensible services (44a-45a). Contrary to the holdings of *Williamson*, *Mr. Steak*, *Fargo* and *Schultz*, however, the Courts below ruled that the offering was nonetheless an "investment contract." The Court of Appeals reached this conclusion merely from the fact that *from the promoter's standpoint*, the persons solicited to purchase the licenses would not have been expected to take an active role in the venture. The Court simply dismissed the variant of latent investor control, which has led the other courts above to remove an offering from the definition of an "investment contract":

> "This is not to suggest that *if it was reasonable to expect investors to exercise their retained rights* under the sales agency agreement in a nontrivial manner the scheme would still be an investment contract. How-

ever, in the case of the Aqua-Sonic offering, this simply was not the case." (18a)

The conflict between the circuits is thus squarely presented: the Fifth, Eighth and Tenth Circuits all hold that where a licensee or purchaser of a business possesses (1) the legal right and (2) the non-illusory practical ability to control his purchase, the transaction is not an investment contract—even if he could be expected to and does in fact delegate all of his responsibility to the promoter or a third party.

The Second Circuit, on the other hand, held as a matter of law that if the promoter could "reasonably expect" that an offeree would delegate his responsibilities to another, the transaction is an investment contract, even though the licensee had the right and the ability to control the business himself.

Thus, if the test of the Fifth, Eighth and Tenth Circuits was applied, the transaction at bar would not be held to be subject to the federal securities laws. Since there are no disputed issues of fact—the District Court cited portions of the Information Memorandum showing that the licensees had the legal right to control their purchase, were not required to hire a sales agent and could fire the sales agent on 90 days notice (32a); and found that the licensees were capable of exploiting their licenses themselves and that no particular expertise was required to do so (44a-45a)—the matter is ripe for resolution as a matter of law by this Court.

II

The Court should utilize this case for the purpose of deciding whether this Court's holding in *SEC* v. *Howey*, defining the test for an "investment contract" under the federal securities laws is still the law.

As this case shows, there is considerable confusion in the lower federal courts with respect to whether this Court's holding in *SEC* v. *Howey*, 328 U.S. 293 (1946), defining an "investment contract" under the federal securities laws, is still the law. In *Howey*, this Court ruled that three elements must be satisfied before a transaction can be characterized as an "investment contract." What must be shown is:

1. An investment of money;
2. In a common enterprise; and
3. On an expectation of profits to be derived *solely* from the efforts of individuals other than the investor. *SEC* v. *Howey*, *supra* at 298-99.

The application of *Howey* to the facts at bar should have led the courts below to conclude that the Aqua-Sonic offering was not an "investment contract." Specifically, as both lower courts acknowledged, it could *not* be established that the licensees had an expectation of "profits *solely* from the efforts of [others]." (*Ibid.*) The Aqua-Sonic offering consisted of an offer to sell a territorial license to market dental products. Each licensee also received an option to purchase, for an additional fee, the services of a sales agency, Ultrasonic, which had offered its assistance in the marketing and distribution of the prod-

uets in question. The services offered by Ultrasonic were optional and not mandatory. Too, as the Information Memorandum and the licensing application made clear, each licensee, whether or not he purchased the services offered by Ultrasonic, was required to take an active role in the successful promotion, marketing, and distribution of the Steri Products. This is thus not a case where a purchaser was somehow led to believe that any profit he might derive from a business venture depended entirely upon the exclusive efforts of the promoter or other third party.

Notwithstanding all of this, the courts below ruled that the Aqua-Sonic offering did constitute an "investment contract," a conclusion based on the courts' view that it was no longer required under *Howey* to establish that a purchaser expected "profits *solely* from the efforts of [others]." The courts below did not reach this conclusion on the basis of any Supreme Court holding on the subject —this Court has never altered the holding in *Howey* in this respect—but rather on an interpretation of *Howey* which the lower courts divined gave effect to what this Court meant—not what it said.

Interestingly, while both the District Court and the Second Circuit refused to apply the *Howey* test strictly, they could not agree on what test should be applied. Thus, the District Court discerned that if the purchaser contemplated that profits from a venture would depend, in part, upon the "undeniably significant" efforts of a third party promoter, the offering thus fit within the definition of an "investment contract." The District Court then wrote.

"The sales agency agreement itself, and the showing as to its actual centrality to the entire scheme, constitutes significant evidence, in the absence of contrary testimony, that the efforts of others would be 'undeniably significant.'" (47a). In so ruling, the District Court cited *SEC* v. *Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973); and *SEC* v. *Koskot Interplanetary, Inc.*, 497 F.2d 473, 479-84 (5th Cir. 1974); decisions which had ruled that the word, "solely," in the *Howey* formulation of an "investment contract" should not be taken literally. These decisions had thus pioneered the substitution of the "undeniably significant efforts" tests for the "profits *solely* from the efforts of [others]" requirement laid down in *Howey*.

The Second Circuit ignored the District Court's revision of *Howey* and engaged in its own efforts to determine what the Supreme Court meant in that seminal case. The Second Circuit opined that if the Supreme Court were to consider the issue of whether the "solely from the efforts of others" test still applies:

> "the Court would not insist on applying that language literally but would consider whether, under all the circumstances, the scheme was being *promoted primarily as an investment* or as a means whereby participants could pool their own activities, their money and the promoter's contribution in a meaningful way." [emphasis added] (13a).

This test, the "primarily promoted as an investment" test, creates a completely new standard to replace, not merely interpret, *Howey*. The Second Circuit, while paying lip service to *Howey*, rejected in its entirety the "profits

solely from the efforts of [others]" test and even the "undeniably significant efforts of others" test announced in *Turner* and *Koskot* and followed by the District Court here.

Thus, though *Howey* has never been overruled (at least by the Supreme Court), there are at least three different present tests now in existence for the definition of an "investment contract." Confusion thus reigns with respect to whether offerings similar to the one at bar must comply with the federal securities laws.

We know of no Supreme Court decision that has authorized the liberalization of the definition of an "investment contract" in the manner accomplished by *Turner* and *Koskot*, and the opinions written in the courts below. Although this Court was presented with the opportunity recently to pass upon the continued viability of *Howey*, the Court demurred and *expressly* left the question open for another day. *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 851, fn.16 (1975).

Conclusion

The Supreme Court should grant the petition for a writ of *certiorari*.

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